

POLICY REFORMS IN GOVERNMENT TO BUSINESS RELATIONS-LOOKING AHEAD

Reforms Initiatives in NBR

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Introduction:

Fiscal management has been a perennial challenge for Bangladesh since its very inception. As a resource constraint nation coupled with limited capacity, we are confronted with persistent pressure to address that challenge. Yet, Bangladesh has been able to demonstrate considerable progress in various fields of economic and social sectors during the past two decades.

Our external dependence in implementing the Annual Development Programs has reduced significantly. Export earnings have grown three fold to near 8 billion dollars in 2004-05 from 1990-91 level. Tax revenue has gone up to nearly Tk 335 billion in FY 2005-06 from a meagre Tk. 73.43 billion in 1990-91. We have been able to maintain around 5% growth of GDP since the 90s and this has hit 6.7% in FY 2005-06. Consequently, incidence of poverty has gone down by 10 percentage points to below 50% of the population¹. Budget deficit has come down to 3.5% of GDP in FY 2005-06, lowest in the last seven years². Total debt stock as percentage of GDP decreased to 48% from 51%. These are no mean achievements by any developing country standards and these are, *inter alia*, largely due to the reforms undertaken by the government in its Fiscal Management.

Reforms so far:

National Board of revenue (NBR), since it came into being by the Presidential Order of 1972, undertook various studies for reforms on a piecemeal basis at different times. Our Tax-GDP ratio being one of the lowest (below 9%) in the region, government has been putting a great deal of efforts in improving that by augmenting its domestic resource mobilization. But the real and tangible reforms were initiated in the early part of 1990s through automation of the customs clearing process and introduction of the Value Added Tax (VAT) in 1991. These two still remain as cornerstones of our ongoing reforms in tax administration. Government's initiatives to augment its domestic resources by giving strong emphasis in improving the management and enhancing the efficiency of the tax administration in addition to the policy of phased reductions and rationalization in tariff and para-tariff paid off considerably. One example of such dividends is that the share of government contribution in development budget rose to some 57% from near zero in the late 80s. Besides, other policy reforms in both direct

¹ Growth & Export Competitiveness, The World Bank Report 31394BD

² *Ibid*

and indirect taxation alongside bringing about improvements in procedural issues, made tax officials more accountable and participatory in decision making.

Direct Tax:

Although contribution of direct taxes to the total tax revenue is just around 20%, processes are underway to make some notable improvements in this regard. Some of these reform initiatives include:

- broadening the existing tax base;
- formation of Large Taxpayers' Unit (LTU) for businesses with high turnover;
- speedy disposal of the pending appeal cases;
- filling of Income Tax return on the basis of self assessment;
- introduction of the four tier rate of tax;
- reduction in the highest slab of the tax rates;
- compulsory submission of the income tax return by the government officials;
- mandatory submission of information pertaining to individual lifestyle and assets with the tax return;
- expansion of the coverage of withholding tax at source to reduce discretionary powers of tax officials and minimize tax payers burden at the year end;

As a result of these actions over the past few years, collection of income tax has almost doubled to Tk. 70 billion in FY 2005-06 from a modest Tk. 37 billion in 2001-02. Moreover, NBR also undertook a series of measures to create conditions conducive to investment, especially in agro processing, fisheries, livestock, poultry, and export oriented industries.

Indirect Tax:

Customs Duty:

Rationalization of customs duty is a continual process. In such exercises, considerations are given to the need of the local trade and industries, budgetary discipline and the bound rate under WTO obligations. A transparent and well defined four tier duty structure for basic raw materials, capital machineries, intermediate goods, and finished products is now in application. Similarly, a rational three tier supplementary duty for luxury items is also in effect to provide more incentives to manufacture of essential items.

Concessional rate of duty is applied for importation of capital machinery and their spares. Duty free import facility under bond is in effect for the export oriented industries. Formulation of policies is underway to ensure proper use of this facility. At the moment, textiles and apparels, leather, and pharmaceutical industries are enjoying the highest policy support in regards to duties and taxes.

Government is fully aware of the need on legal support to deal with the dumping and subsidies issues of the exporting countries. To redress the grievances of the local industries, adequate provisions have been made in the relevant laws, in consonance with WTO, regarding the imposition of anti-dumping and countervailing duty.

A substantial part of customs functions are now being outsourced to the private sector. Four internationally reputed Pre-shipment Inspection (PSI) Agencies have been appointed following a competitive bidding process. These agencies verify and inspect the merchandise supplied by the exporters to Bangladesh in terms of its transaction value, commercial description, HS classification, importability etc. and certify the same to customs authorities directly. Customs assessment of 90% percent of such consignments is made in accordance with the certificates issued by the PSI Agencies. The rest 10% is randomly selected for physical inspection. The process in one hand is helping the business by eliminating possibility of potential harassment by the customs authorities while on the other hand helping the customs officials in developing their skills and capacity building. Nevertheless, in response to the need of the industry in relation to their costs and time, among other items, imports of all capital machinery, samples, and raw materials for export oriented industries are kept out of the purview of this system.

Keeping in line with our commitments to WTO, Bangladesh has been following the GATT Valuation Code or transaction value concept since 2000. This is a very helpful tool for the traders to resolve any disputes with customs in relation to their declared value. The PSI Agencies are required to follow that valuation rule while certifying the prices quoted by the exporters.

Customs operation in Bangladesh is conducted in the major custom houses by computer technology using the ASYCUDA (Automated Systems for Customs Data) software, developed by the UNCTAD. This system was introduced as early as 1993 and is being updated on a regular interval to keep up with the new developments. The last such update was made in 2002 and another one is in the offing next year. The entire customs processing starting from lodgement of documents to payment of duties and release of cargo are now conducted by machines with minimum human intervention. With the latest ASYCUDA++ version, among other standard facilities, an importer can enter his declaration any time of the day, that means 24 hours and 7 days of the week, into the Customs server using the DTI (direct traders' input) facility from his clearing agent's office. Process is underway to make that facility web based (remote DTI) so that the importer can do that from his own premises. ASYCUDA data being the sole source of trade statistics are now being used by all relevant government departments as well as other research organizations to analyze the trade and revenue implications.

To assist the Port Authority in reducing the container congestions, NBR has been encouraging the private sector to operate container terminals/stations. Such

private container stations are currently handling nearly 80% of the total export consignments. Of late on a trial basis a few private container stations have been given permission to handle import cargo (selected on the basis of risk assessment) as well. In phases more private operators will be given this opportunity of handling more of export and import cargo adequately addressing revenue and security issues. Moreover, processes are underway to offer Green Channel facilities for imports and exports to those having good track records.

Value Added Tax (VAT):

VAT system was introduced in Bangladesh in 1991 replacing the age-old excise and sales tax regime. Bangladesh has been one of the pioneers in South and South East Asian region in adopting this modern and progressive system of taxation. Although, this modern taxation method could not be introduced in its comprehensive form to tap its full advantages, yet over the past few years VAT has become the single largest source of government revenue overtaking customs which is by all means a welcome sign. This system is going through a continual reform process with formation of Large Taxpayers' Unit (LTU) being the latest in the series. The services and industries having large operations and turnovers are now brought under this LTU which is equipped with more skilled officers and technology driven systems. In order to reallocate resources and ensuring better and transparent administration for collection of VAT at retail stage, Advance Trade VAT (ATV) was introduced. Under the system, traders are allowed to pay their VAT at rate of 1.5% (assuming a 10% value addition on reselling) at import stage rather than after the sales are completed. This has effected a phenomenal improvement in the revenue collection scenario (more than ten fold increase) as well as helped the traders to get rid of any possible 'harassment' from the VAT officers.

The recent formation of Central Intelligence Cell (CIC) comprising officers from both direct and indirect taxation wings of NBR under the direct supervision of Chairman has been a tremendous success. Given the limitation of resources and logistics, CIC has been able to unearth many sensational instances of tax dodging and evasion.

Reforms Initiatives:

NBR has always been constrained by resources. The collection cost of every Tk. 100 stands at a meagre amount of just around Tk. 1. But there are always rooms for improvement. In spite of all these efforts, NBR does not feel complacent. Allegations are there that pervasive corruption and administrative bottlenecks are still acting as a major impediment for growth in investment and business. These fiascos are lately compounded by litigations. Revenue worth billions of taka is now stuck against the litigations filed by the traders. The disposals of those are also painstakingly slow due to cumbersome legal and administrative.

With this backdrop and the changed circumstances domestically and to address the needs cropping up from intense globalization, NBR has undertaken some initiatives to bring about reforms in tax administration and management in three to four years.

Strategic Development Plan (SDP):

The Strategic Development Plan (SDP) formulated by the NBR envisages greater transparency and accountability from both tax officials and taxpayers. The actions within SDP have led the initiation of the Modernization and Automation Project (MAP) of NBR. Under that project, NBR would undergo massive changes in its outlook and vision within next three to four years. Another project-Chittagong Port Trade Facilitation Project (CPTF)-is also under implementation which is dedicated to improve the operations of customs, port, and communication infrastructure to facilitate export and import activities through the Chittagong Port.

Under the SDP the following goals have been set:

1. Increase revenue collection targets through modernization of tax administration and simplification of procedures;
2. Develop a sound and transparent legal and regulatory system;
3. Identify areas where revenue is at risk and to deal firmly and fairly with non-compliance;
4. Facilitate trade flows leading to speedy clearance of import/export cargo;
5. Develop and manage an effective revenue administration staffed with a well trained, motivated, and professional workforce;
6. Design and deliver fair, responsible, transparent and effective enforcement mechanisms in ways that directly respond to changes in the economic environment and technological opportunities;
7. Foster and develop a taxpayer service culture and improve participation from civil society;
8. Ensure all businesses and individuals are treated in a uniform and consistent manner;
9. Develop a modern IT-based tax administration that is efficient, effective, and transparent.

To achieve those goals NBR has devised seven broad strategies which are as follows:

Strategy 1: Strengthening Organizational Structure

The NBR intends to improve productivity and compliance by including a functional design within its tax-by-tax structure and sharing of some functions across taxes (e.g., Legal, Human Resources, ICT). Collaboration and sharing of information between the VAT and Income tax structural units will be strengthened. The institution has already taken some initial steps in this

direction. For example, several joint audits have been conducted and improvements have been made in cross-referencing income tax and VAT identification numbers.

In the functional model, staffs are assigned to specific functions such as: taxpayer services and registration, accounting, information processing of tax returns and payments, audit, collection of tax arrears, and appeals. The following is a summary of the core benefits that NBR seeks to achieve by moving towards a functional model:

- As in many other tax agencies, there are a limited number of highly talented tax officials available to conduct complex tasks such as audits and collection of arrears. The functional approach allows group of officials to be assigned to these specialized areas. The higher degree of specialization will facilitate detection of under reported turnover, income or profit and the timely collection of arrears.
- A functional approach will deter excessive direct contact between taxpayers and tax officers reducing opportunities for informal exchange of benefits.
- It will provide a strategic element of cross checking among staff so that work performed by one function, such as collection enforcement, acts as a control on other functions, such as auditing and accounting.
- A functional model will permit greater standardization of similar processes across taxes and raise staff productivity (e.g., a taxpayer may have an income tax and VAT debt; therefore it would be more effective to have one area collecting this debt versus having several departments). This will also raise the probability that national policies and strategies are implemented in a unified and consistent manner and facilitate compliance by taxpayers.

NBR plans to move to its new organizational structure in phased stages. The need for a sequenced approach to organizational change arises because of current capacity constraints in the financial, human resource and legal areas. In addition, it is desirable to demonstrate the success of new structures and systems in pilots to ensure broad support for more fundamental organizational changes. The NBR intends to use organizational pilots not as end, but as an intermediate step. These will be rolled out to cover all types of taxpayers and tax officers as administrative capacity improves and experience deepens with implementation of reforms.

The composition of the Board will be strengthened in order to support the move towards a functional model and the implementation of the strategic plan. New board members and/or advisors will be appointed. Short-term recruitment priorities include:

- Change Management Coordinator to assist the Chairman on a day-to-day basis to design, develop, and implement a long-term reform and modernization program;
- Human Resource Management Advisor to be responsible for the development of HR policies and strategies;
- ICT Manager/Advisor to assume ownership of all ICT strategies and initiatives;
- Legal Advisor to provide legal advice on interpretation of tax laws and regulations, assist in the drafting of new laws or amendments, and to support litigation activities;
- Audit Advisor to review, develop, and maintain national audit strategies, policies and plans, and procedures;
- Collection Enforcement Advisor to review, develop, and maintain national collection enforcement strategies, policies and plans

The monitoring and evaluation capacity of the Board will be enhanced through the development of a formal management information system (MIS) that pools relevant indicators of the Board's performance including revenue, but also encompassing arrears, backlog of appellate cases, the number of prosecutions for fraud and their outcomes, indicators of customs clearance time, and the number of inquiries and advanced ruling provided to taxpayers. On completion of the reform, the composition of the Board will have new positions of Members for Human Resources, Audit etc.

Strategy 2: Improving Human Resource Management

The NBR will improve human resource management by implementing a strategy that will re-define functions and job responsibilities; establish new recruitment standards; delineate clear career development paths; establish an effective training program, improve internal communications, and adopt other modern practices including attractive remuneration packages to motivate staff. The NBR will advocate to the Government greater flexibility in the management of its human resources in order to motivate staff, improve productivity and strengthen professionalism and integrity.

The NBR human resource strategy will cover a more focused approach to recruitment procedures, a performance incentive systems, workforce planning, and career development and training, as well as programs for management development. Guided by sound human resources and compensation policies, the NBR will support its staff by improving their skills and knowledge so they can function as effective team members.

To accomplish these objectives a number of personnel related changes will be needed which should be developed in close consultation with the Bangladesh Public Service Commission and the Establishment Ministry. The NBR requires greater autonomy and flexibility with HR issues and should have more significant administrative responsibility over (1) criteria for appointment, (2)

drafting and implementation of a human resource strategic planning; (3) oversight of skills development; (4) change management policies needed to guide implementation of organizational changes; and (5) the authority to explain its reforms to the public. The NBR will explore approaches to human resource policy that are feasible in the Bangladesh context and take into account recent innovations in other Asian countries.

As part of the transition to a functional model, the NBR will prepare a reorganization plan including a new organizational structure for the Board and field offices and related job descriptions for the new positions (e.g. member audit, member collection enforcement, tax registration officer, junior auditor, senior auditor, junior tax collector, and senior tax collector). During the reorganization, staff will be given an opportunity to be transferred to new positions and possibly new field offices. The NBR will explore the option of providing voluntary retirement as a means to support a skill mix more suited to the new goals of the organization.

The human resource strategy will also seek to improve standards of integrity and accountability through such activities as the development of a Code of Conduct and the establishment of an internal audit and tax ombudsman's oversight.

NBR will develop a new internal communication strategy and program to foster greater staff participation and timely distribution of information related to new reforms, policies, and procedures.

Strategy 3: Strengthening the Legal and Regulatory Framework

The NBR plans to undertake a review of the existing laws and regulations with a view to modernizing the legal and regulatory framework. The approach will be to initially focus on priority amendments and eventually to rewrite the laws to ensure clarity, transparency and predictability. The NBR plans to phase-in legal reforms by identifying short term, medium term, and long term improvements to the taxation system.

Legislative changes and reforms will take time to prepare, approve, and implement. Priority will be given to identifying any short- and medium-term changes that could have a fairly immediate impact on revenue collection, while starting to review the broader tax policy framework in order to build a stronger revenue base which minimizes economic distortions, facilitates tax compliance and increases trade. Among others, changes will include:

- The NBR will seek to shorten the list of exemptions: bring new sectors under the tax net, replace tax-holiday with modern accelerated depreciation system: developing appropriate accounting systems for the payment of taxes on turnover basis.

- The NBR plans to increase its legal advisory capacity to deal with the increasing number of litigations. In addition, existing legislation would be reviewed to identify any immediate changes that could be made to the tax laws so that only the appropriate cases choose litigation;
- Given the revenue importance of the VAT, a review would be undertaken to identify structural weaknesses;
- The NBR plans to strengthen compliance by improving its capability for detecting underreported income through effective taxpayer audits and promptly collecting any outstanding arrears. Improved “enforcement” may also require immediate changes to the legislation to ensure auditors and collectors have appropriate powers and authorities to perform these functions more effectively, while ensuring taxpayers are treated in a fair and consistent manner and is not subjected to harassment;

All amendments introduced since the enactment of the tax law should be compiled allowing taxpayers to have an updated view of the existing legislation.

Strategy 4: Strengthening the Effectiveness of the Large Taxpayers Units

Effective administration of large taxpayers will be improved through the strengthening of the Large Taxpayer Units for Income Tax and VAT.

The NBR will give priority to finalizing the implementation of new tax administration procedures and IT systems in both LTU’s. This includes the following:

Taxpayer services and registration: The NBR will continue to examine ways to improve its assistance and services to taxpayers. This will include but not be limited to: (1) further improvements to the services offered by the recently established “help desk” to facilitate taxpayers’ compliance, (2) further simplification of tax forms, and (3) conducting public awareness campaigns with a view to obtaining feedback on reforms. The NBR will also ensure that all businesses are registered.

Filing and payment of taxes: The NBR will continue to find ways to make it easier and faster for businesses to file tax declarations and make payments. In the short term, this could involve further simplification of the tax forms. In the medium to long term, this could include electronic filing of all types of tax declarations and online payment of taxes.

Audit and collection enforcement: Attention will be given to strengthening the capacity of LTU staff for conducting audits in order to ensure large taxpayers are not under reporting their income and improvements will be made in procedures for collecting tax arrears. The objective will be to ensure all large taxpayers are treated in a fair and consistent manner and that they are complying with the tax legislation. The result will be a core group of officials having the basic

knowledge and experience to conduct audits and collect arrears and also a core group of officials having more advanced and specialized skills in dealing with the more complex audit and debt recovery cases.

Adequate staffing and training: The above will require extensive training, and NBR will take steps to ensure that LTU's are adequately staffed to deal with the volume of large taxpayers.

Collaboration between the LTU's and data sharing: The LTU's will facilitate the sharing of data and will conduct joint audits whenever deemed necessary.

Regional Branch of the LTU's: The NBR will establish regional branches of the central LTU's in order to provide better services to taxpayers (including taxpayer information and filing and payment) located outside Dhaka. The central LTU's will maintain responsibility for all large taxpayers.

Strategy 5: National Implementation of Tax Administration Functions/Procedures

The NBR plans to extend the new tax administration functions and procedures introduced in the LTU's to cover small and medium taxpayers throughout the country.

Improving the administration of small and medium sized taxpayers will take more time to complete; therefore, the NBR will need to phase in the reforms over a carefully planned period. Once the administration of large taxpayers is improved, the NBR will shift its attention to medium sized taxpayers and then to small taxpayers. This involves the following:

Taxpayer services and registration: The most important challenge will be to effectively deal with the needs of these different sized customers. The NBR will find ways to improve services offered to this largest group of taxpayers. This will require specialized brochures and forms to cater to their specific needs. Public awareness sessions will be carried out throughout the country to ensure this group fully understands the tax system and their specific obligations. It is easier for small and medium sized businesses to go undetected and escape their obligations for being registered. The challenge for the NBR will be to assign a unique TIN to all small and medium sized businesses.

Filing and payment of taxes: Given the significantly larger number of small and medium sized businesses, the NBR will need to find ways to make it easier and faster for businesses to file tax declarations and to make payments. This could include further simplification of the tax forms.

Audit and collection enforcement: New risk assessment techniques will be introduced to identify which small and medium sized businesses have greater probability of under reporting income. This will be critical as there will not be

enough human resources to audit each taxpayer. Collection of tax arrears from small and medium sized businesses will be closely monitored, too.

Role and function of field offices: The adoption of the new functional organizational model will require the NBR to undertake a careful review of the mandate, role and responsibilities of zonal and circle offices. In the future, some offices may be converted to “Taxpayer Service Offices” and refocused on providing services to the private sector (e.g. help desk, receipt of tax declarations). Other offices may have staff assigned to work on specialized functions such as audit or collection enforcement.

Training: The challenge will be to effectively train a larger group of officials on how to deal with new modern tax administration procedures that are focused by tax function (e.g. taxpayer services, audit, collection enforcement).

Strategy 6: Customs Modernization and Trade Facilitation

The NBR remains committed to continuing modernization of customs operations and implementation of additional measures for facilitating trade. This will speed up clearance of import/export cargo and stimulate industrial development and economic growth.

In the short term, the NBR will give priority to consolidating ASYCUDA at the main checkpoints.

Although the PSI system will continue for a few more years, NBR will focus on building a strong in-house valuation capacity that will eventually replace it. Full implementation of GATT valuation procedures will be crucial. The Customs Tariff has been consolidated, simplified, and published in a single document showing the maximum rate applicable per tariff item. The number of tariff lines has been reduced to about 6500, but the system remains complicated due to multiplicity of rates for similar products, various exemptions and end-user specific concessions. The NBR will continue to simplify and rationalize the tariff structure to increase transparency and ease of administration.

An important administrative reform in customs is to move from physical control covering most goods to post-clearance control covering shipments for which risk factors indicate the potential of under invoicing or other form of evasion. While some progress has been achieved in recent years, the NBR will need to reform its customs procedures further to de-emphasize extensive physical inspection at the point of entry, by utilizing post clearance auditing and other checks that focus on transactions where the risk of underreporting is greatest. NBR will develop a plan to adopt a phased transition spanning several years to a type self-assessment for customs.

Steps will also be taken to further strengthen the inspection and anti-smuggling programs, continue strengthening the effectiveness of bonded warehouse

supervision, and ensure full implementation of the recently developed Duty Draw-back procedures.

Training of NBR Customs officials will be a key priority. A better trained workforce will lead to increased revenues, speedier trade clearance and will facilitate the constant challenges of adopting international conventions and standards (e.g. WCO, WTO, Kyoto Convention).

Strategy 7: Computerization of the NBR

The NBR intends to make more productive use of information technology (IT) as a way to increase the efficiency, effectiveness and transparency of revenue collections.

Establishing an ICT unit in the NBR: Presently, there is no organizational unit responsible for managing the overall design, development, and implementation of IT solutions. The NBR strategy includes the establishment of a unit in the NBR to be responsible for all ICT initiatives. It will provide the institution with the ability to evaluate its overall ICT needs and assess cost-effective alternatives for meeting them, including both outsourcing and building expanded internal IT capability. The unit will develop a time-bound ICT procurement plan, policies for IT maintenance, asset management and security, and establish procedures and protocols for data exchange and on-line access within the NBR and externally.

Requirement for a consolidated NBR ICT strategy: While some progress has been made in automation of customs operations, the automation of VAT and Income Tax has not moved forward at the same pace. Most field offices have limited or no IT equipment and few staff have adequate IT qualifications. There is a growing need to ensure systems developed in the Customs, VAT, and Income Tax areas that are compatible and integrated so as to allow easy sharing of information. National standards for procurement of equipment and development of applications will also have to be formulated.

Improve Trade Facilitation:

Under the CPTF project, electronic submission of cargo manifest is also being implemented by NBR to track cargoes coming into and going out of Bangladesh. This will significantly improve the port congestion crisis and deter any illegal attempt to take any consignment out of the port area without payment of duties.

NBR is to install container scanners in Chittagong Port. This will substantially reduce the need for physical inspection of goods and act as an effective deterrent for the unscrupulous trade transactions through false declaration. This would considerably decrease the customs clearance time as well. This facility will be extended in other ports in phases.

Conclusion:

NBR has a strong conviction that if these reform processes are effectively implemented, Bangladesh's tax administration would reach high standard and create visible inducements for the trade and investment in the country. Besides, the prevalent inequality in income distribution would be redressed to make it fairly equitable.

Finally, in order to enable NBR to succeed in implementing the SDP, a serious commitment from all concerned is a prerequisite. Nevertheless, to have any meaningful outcome from these reforms overall good governance especially in key areas like law and order, banking and finance, legal affairs, communications, power and energy and socio-political stability is the overriding necessity.